

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1917.

No. 593.

THE UNITED STATES OF AMERICA, PETITIONER,

vs.

THE CLEVELAND, CINCINNATI, CHICAGO & ST. LOUIS
RAILWAY COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SIXTH CIRCUIT.

INDEX.

	Original.	Print.
Caption.....	a	1
Transcript of record from the District Court of the United States for the Southern District of Ohio.....	1	1
Petition.....	1	1
Præcipe for summons.....	2	2
Answer.....	3	3
Amendment to answer.....	6	5
Opinion of Judge Hollister.....	6	5
Verdict.....	11	10
Motion for a new trial.....	12	10
Entry overruling motion for a new trial.....	12	10
Judgment on verdict.....	12	10
Bill of exceptions.....	13	11
Exhibit A—Stipulation of facts.....	15	12
Petition for allowance of a writ of error.....	17	14
Assignment of errors.....	18	15
Order allowing a writ of error.....	19	15
Bond on writ of error.....	19	15
Writ of error.....	21	16
Citation and service.....	22	17
Præcipe for record.....	23	18
Certificate of clerk.....	23	18
Appearance for plaintiff in error.....	25	19
Order of argument and submission.....	25	19
Judgment.....	27	19
Opinion, per curiam.....	29	20
Clerk's certificate.....	31	21
Writ of certiorari and return.....	32	22



a United States Circuit Court of Appeals for the Sixth Circuit.

THE CLEVELAND, CINCINNATI, CHICAGO & S. LOUIS RAIL- way Company, plaintiff in error, <i>versus</i> THE UNITED STATES OF AMERICA, DEFENDANT IN ERROR.	} No. —.
---	----------

Error to the District Court of the United States for the Southern
District of Ohio, Western Division.

Transcript of record.

HARMON, COLSTON, GOLDSMITH & HOADLY, *Cincinnati, Ohio,*
Attorneys for Plaintiff in Error.

STUART R. BOLIN,
United States Attorney in and for the Southern
District of Ohio, Cincinnati, Ohio,
Attorney for Defendant in Error.

1 The District Court of the United States, Southern District of
Ohio, Western Division.

Transcript of record.

Petition.

(Filed September 16, 1914.)

United States District Court, Southern District of Ohio, Western
Division.

THE UNITED STATES OF AMERICA <i>vs.</i> THE CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS Railway Company.	} No. 2426.
--	-------------

Now comes the United States of America, plaintiff, and for cause
of action says that the defendant, the Cleveland, Cincinnati, Chicago
and St. Louis Railway Company, is a corporation organized under
the laws of the States of Ohio, Indiana, and Illinois, and that it has
a principal place of business at Cincinnati, in the State of Ohio, and
in the first internal-revenue district of said State; that by virtue of
section 38 of the act of Congress of August 5, 1909 (known as the cor-
poration excise tax law, 36 Stat., 112), defendant for the year 1909
became indebted to the United States in the amount of one per centum
upon its entire net income over and above five thousand dollars
(\$5,000.00) received by it from all sources during said year, and that
as the law directed, said defendant made return of its said net income

for said year to the collector of internal revenue of the first district of Ohio, showing that its said net income for said year upon which tax should be paid amounted to three million one hundred and sixty-one thousand three hundred and eleven dollars and ninety-one cents (\$3,161,311.91), one per centum (1%) of which sum then and there became due and payable to the United States, amounting to thirty-one thousand six hundred and thirty-one dollars and twelve cents (\$31,631.12), which sum was by said defendant paid to the collector of internal revenue for the first district of Ohio.

Plaintiff further says that said return showing defendant's net income, upon which said tax of one per centum (1%) should be paid, to be three million one hundred and sixty-one thousand three hundred and eleven dollars and ninety-one cents (\$3,161,311.91) was not a correct and true return of the said defendant's net income for said year; that in said return there was wrongfully and unlawfully deducted from its net income interest amounting to-----

Loss in operation of Central Indiana Railway-----	\$386,478.80
Profit and loss credits omitted-----	52,640.92
	870,742.21

Total-----	1,309,871.93
------------	--------------

From this should be deducted debits to profit and loss account amounting to thirty-two thousand nine hundred and forty-three dollars and sixty-two cents (\$32,943.62), leaving one million two hundred and seventy-six thousand nine hundred and twenty-eight dollars and thirty-one cents (\$1,276,928.31) additional net income upon which the tax of one per centum (1%) for the year 1909 should have been paid, amounting to twelve thousand seven hundred and sixty-nine dollars and twenty-eight cents (\$12,769.28), which said sum has been demanded of the said defendant and which it has refused to pay.

The United States of America claims there is justly due it from the said defendant the said sum of twelve thousand seven hundred and sixty-nine dollars and twenty-eight cents with interest from July 1, 1910;

Wherefore plaintiff asks judgment against said defendant, the Cleveland, Cincinnati, Chicago and St. Louis Railway Company, in the amount of twelve thousand seven hundred and sixty-nine dollars and twenty-eight cents (\$12,769.28) with interest from July 1, 1910, and with such other added penalties as the law may direct and for its costs herein.

THE UNITED STATES OF AMERICA,
By SHERMAN T. McPHERSON,

United States Attorney in and for the Southern District of Ohio.
(Duly verified.)

Precipe.

To the Clerk:

Please issue summons for the within-named defendant, the Cleveland, Cincinnati, Chicago and St. Louis Railway Company, return-

able according to law. Endorse: Action for money only; amount claimed \$12,769.28, with interest from July 1, 1910.

SHERMAN T. MCPHERSON,

United States Attorney in and for the Southern District of Ohio.

3

Answer.

(Filed November 23, 1914.)

Now comes defendant, and, for answer to the petition or so much thereof as it is advised it is necessary or material to make answer to, says:

It admits it is a corporation organized under the laws of the States of Ohio and Indiana, and that it has a principal place of business at Cincinnati, in the State of Ohio and in the first internal-revenue district of said State. It admits that by virtue of section 38 of the act of Congress of August 5, 1900, known as the corporation excise tax law, it became indebted to the United States in the amount of one per centum upon its entire net income over and above the sum of \$5,000 received by it from all sources during said year. It admits that it made a return of its said net income for said year to the collector of internal revenue of the first district of Ohio, and it admits that said return showed that its net income, upon which tax should be paid, amounted to \$3,161,311.91, upon which there became due and payable to the United States one per centum thereof, amounting to \$31,631.12; and it admits that it paid said sum to the collector of internal revenue for the first district of Ohio.

It admits that in said return it made certain deductions, the amount of which is set forth in the petition; and it admits that certain of said deductions were improper and should not have been deducted from its net income, but that certain others, claimed in the petition to be improper and which should not have been deducted from the net income, were properly deducted from said net income, as will hereinafter more in detail appear.

It admits the amount of interest deducted from its net income, amounting to \$386,478.80, was improperly deducted therefrom, and that it is liable to tax thereon. It denies that the item "Loss in operation of Central Indiana Railway" was improperly deducted therefrom, but avers that the same was the amount expended by this defendant, in cash, to pay its share of the deficit in the operating expenses of the Central Indiana Railway, of which this defendant held at said time one-half of the capital stock, and to pay interest on the bonds of the Central Indiana Railway Company, the interest whereof had been guaranteed by this defendant, and avers that the same was properly deducted from its gross income in the ascertainment of its net income.

4

The item contained in the petition, which it is averred therein was wrongfully and unlawfully deducted, and therein stated to be "Profit and loss credits omitted" to the amount of

\$80,742.21, is composed of sundry items, a portion whereof were properly deducted and upon which, by reason thereof, this defendant is not liable to taxation, and the remainder were not properly deducted. One of said items is the difference between the price at which this defendant sold 30,000 shares of the stock of the Chesapeake & Ohio Railway Company, which had been purchased by this defendant in January, 1900, for the sum of \$981,427.92, and which this defendant sold, on January 28, 1909, for the sum of \$1,795,719.00, said difference amounting to the sum of \$814,291.08; and this defendant avers that the increase in the value of said stock did not accrue between January 1, 1909, and January 28, 1909, the date at which said stock was sold, but that much the greater part thereof accrued prior to January 1, 1909; that the market value of said stock on December 24, 1908, the last date in that year on which there were sales upon the market, was the sum of \$58.37½ per share, and that the difference between said market value of said stock on December 24, 1908, and the price at which the same was sold by the defendant was, to wit, the sum of \$1.48½ per share, and that the gross difference, \$44,460.00, is the only part of said sum of \$814,291.08 which is subject to the tax sought to be collected herein.

And this defendant further avers that between May, 1882, and the 30th day of June, 1900, the Mt. Gilead Short Line, operated by this defendant, had not earned its operating expenses, and that the loss in operating the same during said period amounted to the sum of \$19,376.40, no portion of which has ever been paid to this defendant; and which this defendant has no means of collecting, as, under the contract by virtue whereof this defendant operates the said Mt. Gilead Short Line, this defendant is not entitled to charge the owners thereof with any deficit in the operating expenses. This defendant avers that on June 30, 1900, this defendant charged the said deficit, which had theretofore been charged to the said Mt. Gilead Short Line, to profit and loss; and that in the year 1909 the said amount was credited back to profit and loss and charged to the Mt. Gilead Short Line. This defendant avers that the said crediting was improper; that it has no means of collecting the same, and the same never has been or will be collected.

This defendant admits that the other items entering into and constituting a part of said \$870,742.21, were improperly deducted, and that it is liable to be taxed on the same.

5 And this defendant, further answering, says that if, according to the true tenor and effect of the said act of Congress hereinbefore referred to, it be liable for taxation on the said sum of \$814,291.08, that then and in that event it is entitled to credit in the further sum of \$508,988.19, which this defendant avers should, in that event, be deducted from its gross income in order to the correct ascertainment of its correct income under the following circumstances:

It avers that during the year 1909 it discovered that one Warriner, who was then its local treasurer, had embezzled and appropriated

to his own use, during a series of years up to and including said year 1909, the sum of \$591,988.19. That of said amount the sum of \$83,000.00 had been actually embezzled between January 31, 1909, and December 31, 1909, but that the whole of said embezzlement was discovered during the year 1909, and the whole amount thereof was charged to profit and loss during said year 1909. It avers that, by reason of his said embezzlement, said Warriner became and was indebted to this defendant in said sum of \$591,988.19, whereof the sum of \$83,000.00 actually embezzled by said Warriner during the year 1909 has heretofore been deducted from this defendant's gross income for said year in computing its net income, but that the remainder thereof is an uncollectible, bad debt, charged off during said year 1909.

Wherefore this defendant prays that, in case it shall be determined by the court that it is liable for taxes on the said sum of \$814,291.08, the court will find and determine that it is entitled to deduct from its gross income the further sum of \$508,988.19 by reason of the facts hereinbefore set out.

Attorneys for Defendant.

(Duly verified.)

Amendment to answer.

(Filed April 10, 1916.)

Now comes the defendant and by way of amendment to its answer says that it denies that any portion of the amount realized upon the sale of 30,000 shares of Chesapeake & Ohio Railway Company stock mentioned in the answer herein is subject to the tax sought to be collected in this cause, and it withdraws the admission contained in its answer that the sum of \$44,460.00, being part of the amount received upon the sale of said 30,000 shares of stock of the Chesapeake & Ohio Railway Company, is subject to the tax sought to be collected herein.

HARMON, COLSTON, GOLDSMITH & HOADLY,
Attorneys for Defendant.

(Duly verified.)

Opinion of Judge Hollister.

(Filed February 23, 1916.)

The action was brought to recover from the defendant a tax imposed under the act of Congress of August 5, 1909, section 38 (36 U. S. Stat. at L., pt. 1, pp. 11, 112), upon property claimed by the Government to be net income received during the year 1909, and omitted by the defendant in its return of net income received during the year. The answer and stipulated facts containing concessions on both sides as to the propriety of the return in a number of respects leave between the parties irreconcilable differences, 1st, upon the

meaning and application of the law with respect to profits made by the defendant upon the sale by it, January 28, 1909, at \$1,795,719.00, of 30,000 shares of stock in the Chesapeake & Ohio Railway Co., bought by it in 1900 for \$981,427.92; 2nd, upon a deduction claimed by defendant of \$508,988.19 embezzled by its treasurer during a number of years prior to 1909 and discovered during that year.

7 1. The Government claims that the profit, \$814,291.08, is subject to the tax as net income received during the year 1909. Of this sum the defendant admits the proper application of the tax to \$44,460.00, which is the difference between the market value of the stock on December 24, 1908, the last day in that year in which sales were made, and the market value realized on sale, January 28, 1909.

As much of section 38 as, for present purposes, is necessary for consideration, reads:

"Every corporation * * * organized for profit and having a capital stock represented by shares * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year."

What does the entire net income received from all sources during the year, as applied to the facts here, mean?

Probably the stock, fluctuating in value more or less from day to day, increased in value every year until the time of the realization of defendant's handsome profit on the investment. The increased value of the stock at any time was gains or profits, but in no sense "income." Such increase was said by Mr. Justice Field, in *Gray v. Darlington*, 15 Wall., 63, to be merely an increase of capital. Manifestly, increase of capital would not be subject to the tax, and the increase of capital might continue to the very day of sale. If the contention of the defendant on this main proposition is correct, there is no reason why the gain, turned into money by the sale, should be measured by the market value on December 24th, or on any other day prior to the day of sale, except, say, the day before the sale. If on the day of sale the market value (the sum realized) was less than the value of the day before, then there would be no net income from the investment, however large the amount received in 1909, over the amount paid for the stock in 1900 might be. In such case there would be no net income subject to the tax. It seems to me that the defendant's concession that the net income received in 1909 is the profit on assets turned into money through the increased price received January 28, 1909, involves the admission that the last market value of the stock immediately preceding the sale is the figure which must be taken for comparison between it and the amount realized at the sale in determining whether there was any net income received during the year; for, if the gains were capital, they were capital up to the moment of the sale.

8 These gains were capital in the sense that they were assets, and they were still, when converted into money, assets and capital.

The concession seems to be also an admission that profit during the year it is turned into money is net income. The statute says nothing about gains and profits received during the year. If these are capital in the sense of *Gray v. Darlington*, they can not be taxed as income.

Ordinarily, the income on stock is the annual dividends yields. It does not appear whether the stock yielded any dividend at any time while in the defendant's ownership. So income of that kind is out of the case.

It is manifest that the money tied up in the stock of another railroad is not productive capital employed in the operation of the railroad. It has no income as productive capital. Why it was acquired does not appear. It may have been so that the defendant, connecting at Cincinnati with the Chesapeake & Ohio, wished a voice as a large owner of the stock of the Chesapeake & Ohio in the management of that road to the end that it might participate largely, if not entirely, in the distribution, north and west, of Chesapeake & Ohio traffic destined for those points on the defendant's line, and in the distribution of traffic originating on its line destined for territory reached by the Chesapeake & Ohio. It might be that the stock was bought for an investment, or even merely as a speculation. But whatever the reason for its acquirement was, it had, as assets or capital employed in the operation of the railroad, no measurable income-producing value. So while in one sense this stock may have been capital, it could, as such, yield no measurable income in the ordinary meaning of that word. It never could yield an income until it was sold. Obviously that income would be what it earned. It earned the difference between what it cost and the price it realized on sale. It is true the earnings were profits accumulating through a series of years, but they never came in as income and could not until the stock was sold. Then they came in and the net income (the amount earned by this capital) was then received.

The defendant relies upon *Gray v. Darlington*, 15 Wall., 63. In that case the act of 1867 (14 U. S. Stat. at L., sec. 13, p. 478) provided:

"There shall be levied, collected, and paid annually upon the gains, profits, and income of every person, * * * whether derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation, * * * or from any other source whatever, a tax of five per centum on the amount so derived over one thousand dollars. * * * And the
9 tax herein provided for shall be assessed, collected, and paid upon the gains, profits, and income for the year ending the thirty-first day of December next preceding the time for levying, collecting, and paying said tax."

And "in estimating the gains, profits, and income of any person there shall be included all income derived from interest upon notes, bonds, and other securities of the United States; profits realized within the year from sales of real estate purchased within the year or within two years previous to the year for which income is esti-

mated; * * * all other gains, profits, and income derived from any source whatever, * * *."

Darlington, in 1835, the owner of certain Treasury notes, exchanged them for United States bonds. In 1869 he sold the bonds at a profit of \$20,000.00, upon which the assessor, claiming the profit to be "gains, profits, and income derived from any source whatever" of Darlington for the year 1869, assessed the tax. Darlington paid under protest and sued to recover. The assessor's demurrer was overruled, and the court being of opinion that the \$20,000.00 was not profits, gains, and income for the year 1869, because there were other years to be taken into consideration. The reason seems clear enough; but, in the course of the opinion, Mr. Justice Field said (p. 66):

"The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase in capital."

This language was employed with respect to the facts and the particular statute under construction in that case. The question to be decided in the case was clear cut, and the answer to it was plain. Mr. Justice Field said (p. 65):

"The question presented is whether the advance in the value of the bonds, during this period of four years, over their cost, realized by their sale, was subject to taxation as gains, profits, or income of the plaintiff for the year in which the bonds were sold. The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of property during a series of years can, in no just sense, be considered gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects

of taxation only to annual gains, profits, and income. Its
10 general language is 'that there shall be levied, collected, and paid *annually* upon the gains, profits, and income of every person,' derived from certain specified sources, a tax of five per cent., and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December next preceding the time for levying, collecting, and paying said tax.' This language has only one meaning, and that is that the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year."

The learned justice then dealt with certain exceptions in the statute (p. 66):

"Another exception is implied from the provision of the statute which requires all gains, profits, and income derived from any source whatever, in addition to the sources enumerated, to be included in the estimation of the assessor. The estimation must, therefore, neces-

marily embrace gains and profits from trade and commerce, and these, for their successful prosecution, often require property to be held over a year. In the estimation of gains of any one year the trader and merchant will, in consequence, often be compelled to include the amount received upon goods sold over their cost, which were purchased in a previous year. Indeed, in the estimation of the gains and profits of a trading or commercial business for any one year the result of many transactions have generally to be taken into account which originated previously."

This railway company was dealing with this stock as a trader or merchant deals with his wares. He may have them on his shelves for many years, and, no doubt, they are capital assets all the time, but he certainly receives no income from them until he sells them, and no net income unless there is a difference in his favor between the cost and the price at which he sells.

Annual gains, profits, and income for a particular year are quite different from net income received during a year. No doubt Congress, in the enactment of August 5, 1909, had in mind the statute of 1867 and the decision of the Supreme Court construing it. The change in language indicates a change in intention. In the earlier act Congress excluded from the operation of the tax earnings of Darlington's investment for several years, because they were not profits, gains, or income for the particular year for which the tax was assessed. In the latter act they imposed a tax on the amount of the earnings *received* during the particular year.

The defendant's return for 1909 should have included \$814,291.08, the difference between the cost of the stock and the amount realized on January 28, 1909.

2. Prior to 1909, covering a period of several years, the treasurer of the defendant had embezzled from it \$508,988.19, a fact not discovered until in the year 1909. The defendant claims a deduction of this amount from its gross income. Under the statute the defendant was entitled to deduct "the total amount of losses actually sustained during the year."

The time of the discovery of a loss bears no relation to the date the loss was sustained. The loss was sustained when the theft occurred, although the defendant did not know at the time of the depletion of its assets. As each embezzlement occurred, the defendant was poorer to the extent of it. It then sustained a loss. One of the definitions of "sustained," is to "undergo." As each embezzlement occurred, the defendant underwent the loss of that much money. It is clear that the defendant is not entitled to the deduction claimed.

An order may be taken in conformity with the views herein expressed.

HOLLISTER, *District Judge.*

WILLIAM WALLACE, JR.,

Assistant Attorney General, for the Government.

HARMON, COLSTON, GOLDSMITH & HOADLY,

Attorneys for Defendant.

Verdict.

(Filed April 11, 1916.)

We, the jury, herein do find the issues joined in favor of the plaintiff and assess its damages at sixteen thousand six hundred sixty-seven dollars seventy-seven cents (\$16,677.77).

Signed WM. BIEDENBENDER,
Foreman.

12

Motion for a new trial.

(Filed April 11, 1916.)

Now comes the defendant and moves the court to set aside the verdict heretofore rendered herein and to grant a new trial of the above entitled cause, upon the following grounds:

1. The court erred in directing the jury to find a verdict in favor of plaintiff.

HARMON, COLSTON, GOLDSMITH & HOADLY,
Attorneys for Defendant.

Entry.

(Entered by Judge Hollister April 11, 1916.)

It appearing to the court that the motion for a new trial herein filed is not well taken;

Upon consideration whereof the court does hereby overrule the same, to which overruling of said motion the defendant herein excepts.

HOLLISTER,
U. S. District Judge, S. D. O.

Judgment entry.

(Entered by Judge Hollister April 11, 1916.)

This cause coming on this day to be heard upon the verdict of the jury this day returned, and it appearing from said verdict
13 that judgment is rendered in favor of the plaintiff against the defendant in the principal sum of \$12,378.45, together with interest thereon at 6% from July 1, 1910, being the amount of \$4,289.32, being the total amount of judgment rendered in said verdict of \$16,667.77; it is therefore—

Ordered, adjudged, and decreed that the plaintiff recover from the defendant the said sum of \$16,667.77 on the cause of action set out in the petition herein and the costs herein expended;

And judgment is hereby rendered against the defendant on its answer and cross petition filed herein under the style of "Answer." To all of which the defendant excepts.

HOLLISTER,
United States District Judge, S. D. O.

Bill of exceptions.

(Filed April 21, 1916.)

Be it remembered that at the trial of this cause at the April term 1916 of the District Court of the United States, within and for the Western Division of the Southern Judicial District of Ohio, the Honorable Howard C. Hollister presiding, the following proceedings were had, to wit:

A jury was duly empaneled and sworn according to law to try said cause.

Thereupon it was stipulated and agreed in open court by and between counsel for plaintiff and counsel for defendant as follows, to wit:

That no reply need be filed by the plaintiff to the answer and its amendment of the defendant, but that the trial shall proceed in all respects as if such reply had been filed denying all allegations of new matter in said answer and its amendment.

And thereupon the plaintiff to maintain the issues on its part offered in evidence a certain stipulation in writing as to the facts of this case, theretofore entered into between the parties hereto, a copy of which stipulation is hereto attached, marked "Exhibit A" and made a part hereof; and thereupon the plaintiff rested its case, and thereupon the defendant rested its case; and the foregoing was all the evidence offered by either party at the trial of this cause.

And thereupon the plaintiff above named, the United States of America, moved and requested the court to instruct the jury to return a verdict for the plaintiff for the amount of the tax claimed, and interest thereon at 6% per annum to the date of this judgment, on the following sums described in the petition, to wit:

(A) Interest wrongfully deducted by defendant in its return of net income as admitted by the defendant in its answer	\$386,478.80
(B) 1. Profit on the sale of Chesapeake & Ohio Railroad Company stock not returned by defendant in its return of net income	\$814,291.08
2. Credits wrongfully deducted by defendant in its return of net income as admitted by defendant in its answer	\$37,074.73
	<hr/>
	\$1,237,844.61

And thereupon the court directed the jury to find a verdict for the plaintiff for 1% of the total of the above sum and interest at the rate of 6% from July 1st, 1910, to April 10th, 1915, to which the defendant then and there in the presence of the jury excepted:

And thereupon the jury under such peremptory instructions returned a verdict in accordance therewith for the plaintiff, as appears of record in this case.

And thereafter within three days came the defendant by its counsel and filed its motion for a new trial, which motion the court overruled, to which action and ruling of the court counsel for the plaintiff at the time duly excepted.

And now, in furtherance of justice and that right may be done, the said defendant presents the foregoing as its certain bill of exceptions in this cause and prays that the sum may be settled and allowed, signed, and certified by the judge, and made a part of this record, as provided by law.

All of which is accordingly done this 21st day of April, 1916.

HOWARD C. HOLLISTER,
Judge of United States District Court
Southern District of Ohio.

Exhibit A—Stipulation.

The United States District Court, Southern District of Ohio, Western Division. No. 2426.

The United States of America v. The Cleveland, Cincinnati, Chicago and St. Louis Railway Company.

It is hereby stipulated between the parties hereto that the following statement, together with the admissions contained in the pleadings, shall be deemed proven facts of this case for the purposes of the trial of the issues raised by the pleadings herein in the said district court and in any court of error to which this cause may be taken.

1. The defendant in January, 1900, purchased on the New York stock market thirty thousand shares of the capital stock of the Chesapeake & Ohio Railway Company for the sum of \$981,427.92. On January 28, 1909, the defendant sold this stock on that market for the sum of \$1,795,719. The difference between these two amounts was entered by the defendant on January 31, 1909, on its business books of account to the credit of profit and loss and is not included in its tax return for the year 1909 as a credit of income for that year, but was included in a statement made up by the examiner of the internal-revenue department under the heading "Profit and loss credits omitted." The "Profit and loss" account on defendant's books was the usual bookkeeping account of that name, to which were charged all losses and credited all gains. The last actual sales of Chesapeake & Ohio stock on the New York stock market prior to January 1, 1909, were on December 24, 1908, on which day the quota-

tions on that stock ranged from high 58½ to low 57½. The stock-market quotations on that stock on December 31, 1908, ranged from 57½ high to 56½ low. The lowest market quotation on that stock between December 24, 1908, and January 28, 1909, was on January 6, 1909, when it ranged from 56½ high to 55½ low. Sales and purchases of this stock were always made on the basis of the stock-market quotations.

2. The defendant, prior to January 1, 1909, was operating under contract the "Mount Gilead Short Line," and said contract contained no provision permitting the defendant to charge the owners of the said Short Line with any deficit in operating expenses. The deficit in expenses of operating the said Short Line from May, 1882, to June 30, 1900, amounted to \$19,376.40, which amount on said
16 latter date was charged by the defendant to said profit and loss account. In the year 1908 the Mount Gilead Short Line showed a profit of some \$112, and, believing that the Short Line might continue to show profits, the defendant, on May 31, 1909, credited said profit and loss account with \$19,376.40, so that it might have an account on its books to which subsequent profits in the operation of the Short Line Railway might be charged. The defendant did not actually receive said \$19,376.40 during the taxing year 1909. This item so credited to said profit and loss account in the year 1909 is part of the item of \$870,742.21 which the plaintiff claims the defendant should have added to its tax return for the year 1909, and which the statement made up by the examiner, hereinbefore referred to, includes under the heading of "Profit and loss credits omitted."

3. The defendant and the Pennsylvania Company, prior to January 1, 1909, were each owner of one-half of the capital stock of the Central Indiana Railway Company. The defendant in addition was, prior to January 1, 1909, the owner of \$750,000 of the first-mortgage bonds of the Central Indiana Railway Company. In the year 1904 the defendant guaranteed the interest on the said \$750,000 of bonds of the Central Indiana Railway Company and sold the same with this guaranty. During the taxing year 1909 the defendant, owing to the default of the Central Indiana Railway Company, paid under said guaranty interest on these bonds to the amount of \$30,000, charging the same on its books to the account of advances to the Central Indiana Railway Company.

Said Central Indiana Railway Company was operated independently of the defendant and of the Pennsylvania Company, and, as its income each month was insufficient to meet its operating expenses, it became necessary for the defendant as owner of said stock to advance moneys to pay said deficit in said operating expenses, and during the taxing year 1909 the defendant did advance the amount of \$22,640.92 for that purpose. This latter amount and the amount of \$30,000 paid for interest on the bonds of the Central Indiana Railroad Company, as aforesaid, make up the amount of \$52,640.92 which the defendant deducted from its return as loss in operation of the Central Indiana Railway.

For a considerable period prior to the first day of January, 1900, the local treasurer of the defendant at Cincinnati had been embezzling the funds of the defendant. The amount so embezzled before the first of January, 1900, was \$508,988.19. Subsequent to the first of January, 1900, and during the taxing year 1900, the additional amount of embezzlement by said treasurer was \$83,000, making a total embezzlement of \$591,988.19. The defendant had no knowledge of this embezzlement prior to the first of January, 1900, and the entire amount was charged by the defendant to said profit and loss account on December 31, 1900. During the year 1910 the defendant collected on account of its claim for this embezzlement the sum of \$54,143.48, which amount was credited to said profit and loss account in said year 1910, and the tax required by law has been paid on said sum of \$54,143.48.

In the year 1913 the defendant collected on account of its claim for said embezzlement the sum of \$4,117.94, which amount was credited to profit and loss in said year, the same having been realized from the sale of a house belonging to said local treasurer which he had conveyed to the defendant. In order to make said sale, it was necessary to pay, on account of a mortgage held by a building and loan association on said property, the sum of \$672.00, which amount was charged to profit and loss, making a net credit of \$3,445.94, which was duly returned for taxation and the taxes thereon paid in said year 1913.

In the year 1914 the defendant credited profit and loss account with the sum of \$1,514.07, being the amount collected by it on its claim on account of said embezzlement, which amount was duly returned for taxation and taxes thereon duly paid; the balance of said claim created by said embezzlement is believed to be uncollectible.

UNITED STATES OF AMERICA,
By T. W. GREGORY, *Its Attorney General*.
THE CLEVELAND, CINCINNATI, CHICAGO & ST.
LOUIS RAILWAY COMPANY,
By HARMON, COLSTON, GOLDSMITH & HOADLY.

Petition for allowance of writ of error.

(Filed April 21, 1916.)

Now comes the defendant herein and respectfully represents to the court that on or about April 1916, this court entered judgment herein in favor of plaintiff and against this defendant, in which judgment and in the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this defendant, all of which will appear in detail from the assignment of errors which is filed with this petition.

Wherefore this defendant prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the

Sixth Circuit for the correction of the errors so complained of, and that a transcript of the record, proceedings, and papers in this cause duly authenticated may be sent to the said Circuit Court of Appeals.

HARMON, COLSTON, GOLDSMITH & HOADLY,
Attorneys for Defendant.

Assignment of errors.

(Filed April 21, 1916.)

Now comes the defendant and assigns the following errors:

1. The court erred in directing a verdict in favor of the plaintiff herein, to which the defendant then and there excepted;
2. The court erred in overruling the motion for a new trial, to which the defendant then and there excepted.

HARMON, COLSTON, GOLDSMITH & HOADLY,
Attorneys for Defendant.

40

Order allowing a writ of error.

(Entered by Judge Hollister April 21, 1916.)

This 21st day of April, 1916, came the defendant, by its attorneys, and filed herein and presented to the court its petition praying for the allowance of a writ of error, together with an assignment of errors, as required by law and by the rules of the Circuit Court of Appeals for the Sixth Circuit, praying also that a transcript of the record and proceedings and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Sixth Judicial Circuit; and that such other and further proceedings may be had as may be proper in the premises.

On consideration whereof the court does allow the writ of error, upon the defendant giving bond according to law in the sum of twenty thousand dollars (\$20,000.00), which shall operate as a superadeas bond.

HOLLISTER, Judge.

Bond on writ of error.

(Filed April 21, 1916.)

Know all men by these presents that we, the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, as principal, and National Surety Company, as surety, are held and firmly bound unto the United States of America in the full and just sum of twenty thousand (\$20,000) dollars, to be paid to the said the United States of America, to which payment, well and truly to be made, we bind ourselves, our heirs, executors, and administrators, jointly and severally, by these

presents. Sealed with our seals and dated this 15th day of April, in the year of our Lord one thousand nine hundred and sixteen (1916).

20 Whereas, lately at a District Court of the United States for the Southern District of Ohio, Western Division, in a suit depending in said court, between the United States of America, plaintiff, and the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, defendant, a judgment was rendered against the said the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, and the said the Cleveland, Cincinnati, Chicago & St. Louis Railway Company having obtained a writ of error and filed a copy thereof in the clerk's office of the said court to reverse the judgment in the aforesaid suit, and a citation directed to the said the United States of America citing and admonishing it to be and appear at a session of the United States Circuit Court of Appeals for the Sixth Circuit, to be holden at the city of Cincinnati, in said circuit, on the twenty-second day of May next.

Now, the condition of the above obligation is such that if the said the Cleveland, Cincinnati, Chicago & St. Louis Railway Company shall prosecute its writ of error to effect, and answer all damages and cost if it fail to make its plea good, then the above obligation to be void; else to remain in full force and virtue.

THE CLEVELAND, CINCINNATI, CHICAGO & ST. LOUIS
RAILWAY COMPANY,

[SEAL.]

By H. A. WORCESTER,
Vice President & General Manager.
NATIONAL SURETY COMPANY,

[SEAL.]

By S. M. FERRIS,
Attorney in Fact.

Sealed and delivered in presence of—

Approved by—
HOWARD C. HOLLISTER,
U. S. District Judge.

21

Writ of error.

(Filed April 21, 1916.)

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

To the President of the United States to the honorable the judge of the District Court of the United States for the Southern District of Ohio, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said district court, before you,

or some of you, between the United States of America, plaintiff, and the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, defendant, a manifest error hath happened to the great damage of the said the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, as by its complaint appears. We being willing that error, if any hath been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceeding aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ so that you have the same at Cincinnati, in said circuit, on the * 22nd day of May next, in the said circuit court of appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said circuit court of appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States, should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 21st day of April, in the year of our Lord one thousand nine hundred and sixteen, and of the Independence of the United States of America the one hundred and fortieth.

B. E. DILLEY,

*Clerk of the District Court of the United States,
Southern District of Ohio.*

Allowed by—

HOWARD C. HOLLISTER,

Judge U. S. District Court, S. D. O.

22

Citation.

(Filed April 21, 1916.)

United States Circuit Court of Appeals for the Sixth Circuit.

UNITED STATES OF AMERICA,

Sixth Judicial Circuit, ss:

To the United States of America, greeting:

You are hereby cited and admonished to be and appear at a session of the United States Circuit Court of Appeals for the Sixth Circuit, to be holden at the city of Cincinnati, in said circuit, on the † twenty-second day of May next, pursuant to a writ of error, filed in the clerk's office of the District Court of the United States for the Southern District of Ohio, Western Division, wherein the Cleveland, Cincinnati, Chicago & St. Louis Railway Company is plaintiff in error and you are defendant in error, to show cause, if any there be, why

* Not exceeding 30 days from the day of signing the citation.

† Not exceeding 30 days from the day of signing.

the judgment rendered against the said plaintiff in error as in the said writ of error mentioned should not be corrected, and why speedy justice should not be done to the parties in that behalf.

Witness the Honorable Edward D. White, Chief Justice of the United States, this 21st day of April, in the year of our Lord one thousand nine hundred and sixteen, and of the Independence of the United States of America the one hundred and fortieth.

HOWARD C. HOLLISTER,
U. S. District Judge, Southern District of Ohio.

Service of the within citation is hereby acknowledged this 21st day of April, 1916.

STUART R. BOLIN,
U. S. Dist. Atty.,
By EDWARD K. BRUCE,
Asst. U. S. Atty.

23

Præcipe.

(Filed April 21, 1916.)

To the clerk of the District Court of the United States for the Southern District of Ohio, Western Division:

Please make up the record in the above-entitled cause, containing the following papers:

1. The petition.
2. The answer.
3. The amendment to answer.
4. The opinion of Judge Hollister.
5. The verdict.
6. Motion for a new trial.
7. Order overruling motion for new trial.
8. Judgment.
9. Bill of exceptions.
10. Petition for the allowance of writ of error.
11. Assignment of errors.
12. Order allowing writ of error.
13. Writ of error.
14. Bond.
15. Citation.
16. This præcipe.

HARMON, COLSTON, GOLDSMITH & HOADLY,
Attorneys for Defendant.

Certificate of clerk.

UNITED STATES OF AMERICA, SOUTHERN DISTRICT OF OHIO, ss:

I, Boyd E. Dilley, clerk of the United States District Court for the Southern District of Ohio, do hereby certify that the foregoing

23 pages contain a full, true, and correct copy of the proceedings in the case of the United States of America against the Cleveland, Cincinnati, Chicago & St. Louis Railway Company, No. 2426 on
24 the docket of said court, as called for in the præcipe set out in full herein, as the same appears from the record and files of this office.

Witness my hand as clerk and the seal of said court, at Cincinnati, Ohio, this 17th day of May, 1916, and of the Independence of the United States the one hundred and fortieth.

[SEAL.]

BOYD E. DILLEY,
Clerk.

25 Proceedings in the United States Circuit Court of Appeals for the Sixth Circuit.

Appearance of counsel.

(Filed May 19, 1916.)

WILLIAM C. COCHRAN, *clerk of said court:*

Please enter my appearance as counsel for the plaintiff in error.

HARMON, COLSTON, GOLDSMITH & HOADLY.

Cause argued and submitted.

(Oct. 9, 1916.—Before Knappen and Denison, C. JJ., and sessions, D. J.)

This cause is argued by Mr. George Hoadly for the plaintiff in error and by Mr. E. K. Bruce, assistant United States attorney, for the defendant in error and is submitted to the court.

26

27

Judgment.

(Filed May 8, 1917.)

Error to the District Court of the United States for the Southern District of Ohio. This cause came on to be heard on the transcript of the record from the District Court of the United States for the Southern District of Ohio and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby reversed and the cause remanded with instructions to enter a new judgment in accordance with the opinion of this court.

Opinion.

(Filed May 8, 1917.)

28

29 Filed May 8, 1917. Wm. C. Cochran, clerk.

No. 2929.

United States Circuit Court of Appeals, Sixth Circuit.

THE CLEVELAND, CINCINNATI, CHICAGO
and St. Louis Railway Company,
plaintiff in error,

vs.

THE UNITED STATES OF AMERICA,
defendant in error.

Error to the District Court
of the United States for
the Southern District of
Ohio, Western Division.

Submitted October 9, 1916.—Decided May 8, 1917.

Before Knappen and Denison, circuit judges, and Sessions, district judge.

Per Curiam: In 1900, the railway purchased 30,000 shares of the Chesapeake & Ohio stock for \$981,427.92. On January 28, 1909, it sold this stock for \$1,795,719. The difference it credited on its books to profit and loss. It did not include any portion of this profit in its return for the year 1909 under the corporation-tax act (36 St., 112), and the Government brought this suit to recover the tax of one per cent. The court below directed a verdict for the plaintiff, and the railway company assigns error.

The proper construction of this statute in the respects now substantially involved has been considered by us in *Doyle v. Mitchell* (235 Fed., 686) and in *Biwabik v. United States*, opinion filed this day. In those cases we have given the reasons for our conclusion that the sum received during 1909 for capital assets sold during that year can not be considered as income under this act, excepting to the extent by which it exceeds the ascertained market value of those assets on January 1st of that year. The principles discussed and adopted in these cases necessarily lead to the reversal of this judgment, excepting with regard to the increased value which accrued after January 1st.

30 In the *Doyle-Mitchell* case it was argued that the assets there involved were acquired for the purpose of sale, and we said that, with such assets, it was customary to take inventories at stated periods, and that only by so doing could we find any workable system of determining the net income of such a business. The assets now involved were not of that character. They were bought for investment and not for current merchandising; but it appears

by the stipulation of fact that the stock had a regular fixed stock-market value of \$57 per share on December 31, 1908. This fact supplies the lack of inventory; and, in every general aspect, the impropriety of treating as income a gain which had occurred before the taxing period began is plainer with respect to property like this, bought for quasi-permanent investment, than with reference to raw materials for manufacture. That this stock was capital assets, under any definition of that phrase, is too plain for question.

The railway insists that the rule of *Gray v. Darlington*, 15 Wall., 63, requires us to exclude from the income for 1909 even the gain that accrued during that year. The precise point decided in *Gray v. Darlington* was that the accretions in value during the previous years were not income for the year in which the property was sold; but, doubtless, some of the language of the opinion would indicate that such accretions were not income even for the year in which they happened. We are not inclined to extend the real judgment of that case so as to cover the gain on the Chesapeake & Ohio stock from January 1 to January 28, 1909. It is true that, as said in the *Biwabik* opinion, we see no reason for thinking in an abstract way that "income," in the corporation-tax law, does not mean the same thing as "income" in prior income taxing laws, but there is no practicable way of ascertaining the income, for a given period, of a business corporation with a great variety of assets, except by comparing market values at the beginning and end of the period; and, as pointed out in the other cases, this has been the administrative interpretation of this law from the beginning.

The judgment is reversed and the case remanded with instructions to enter a new judgment which shall include, on account of this Chesapeake & Ohio stock profit, the tax upon only the balance above \$57 per share.

31 United States Circuit Court of Appeals for the Sixth Circuit.

I, William C. Cochran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing is a true and correct copy of the record and proceedings in the case of *Cleveland, C., C. & St. L. Railway Co. versus The United States of America*, No. 2929, as the same remains upon the files and records of said United States Circuit Court of Appeals for the Sixth Circuit, and of the whole thereof.

In testimony whereof I have hereunto subscribed my name and affixed the seal of said court at the city of Cincinnati, Ohio, this 11th day of July, A. D. 1917.

[SEAL.]

WILLIAM C. COCHRAN,
*Clerk of the United States Circuit Court
of Appeals for the Sixth Circuit.*

The President of the United States of America to the honorable the judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Being informed that there is now pending before you a suit in which the Cleveland, Cincinnati, Chicago & St. Louis Railway Company is plaintiff in error and the United States of America is defendant in error, No. 2929, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Southern District of Ohio, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the United

33 States do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the honorable Edward D. White, Chief Justice of the United States, the eighteenth day of October, in the year of our Lord one thousand nine hundred and seventeen.

JAMES D. MAHER,

Clerk of the Supreme Court of the United States.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, vs.:

I, William C. Cechran, clerk of the United States Circuit Court of Appeals for the Sixth Circuit, do hereby certify that the transcript of the record of the proceedings of this court in the within-entitled case heretofore certified by me for filing in the Supreme Court of the United States was correct and complete as the same then appeared in this court.

In pursuance of the command of the foregoing writ of certiorari, I now hereby certify that on the 22nd day of October, A. D. 1917, there was filed in my office a stipulation in the above-entitled case in the following words, to wit:

In the said Court of the United States, October term, 1917.

THE UNITED STATES OF AMERICA, PETITIONER,

v.

THE CLEVELAND, CINCINNATI, CHICAGO & ST. LOUIS RAIL-
way Company.

} No. 593.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of the record now on file in the office of the clerk of the Supreme Court may be taken as

the return of the clerk of the Circuit Court of Appeals for the Sixth Circuit to the writ of certiorari issued herein.

JNO. W. DAVIS,
Solicitor General.

GEO. HOADLY,
Counsel for Respondent.

Oct. 10, 1917.
(174296)

I further certify that the above is a true and correct copy of said stipulation and of the whole thereof. Witness my official seal, signature, and the seal of said Circuit Court of Appeals at the city of Cincinnati, in said circuit, this 22nd day of October, A. D. 1917.

[SEAL.]

WILLIAM C. COCHRAN,
*Clerk United States Circuit Court of Appeals
for the Sixth Circuit.*

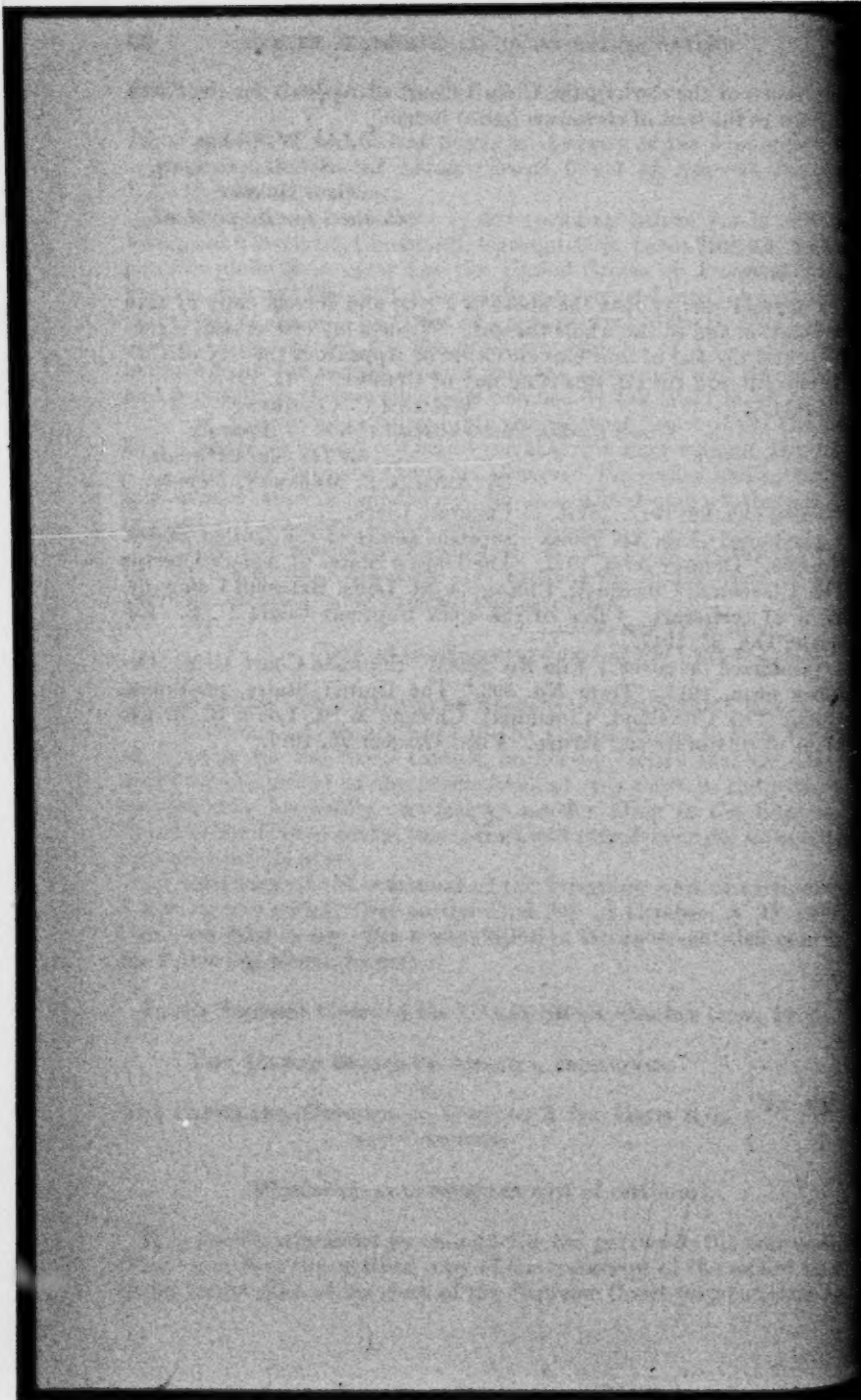
By ARTHUR B. MUSSMAN, *Deputy.*

Filed Oct. 22, 1917. Wm. C. Cochran, Clerk.

(Indorsed: File No. 26060. Supreme Court of the United States. No. 593. October term, 1917. The United States of America versus The Cleveland, Cincinnati, Chicago & St. Louis Railroad Company. Writ of certiorari. Office of the clerk Supreme Court U. S. Received Oct. 25, 1917.

(Indorsed on cover:) File No. 26060. Supreme Court U. S. October term, 1917. Term No. 593. The United States, petitioner, versus The Cleveland, Cincinnati, Chicago & St. Louis R. R. Co. Writ of certiorari and return. Filed October 25, 1917.





In the Supreme Court of the United States.

OCTOBER TERM, 1917.

THE UNITED STATES OF AMERICA, Petitioner, v. THE CLEVELAND, CINCINNATI, CHICAGO & St. Louis Railway Company.	}	No. 593.
--	---	----------

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SIXTH CIRCUIT.*

MOTION BY THE UNITED STATES TO ADVANCE.

Comes now the Solicitor General and moves to advance this case for hearing on a day convenient to the court.

The case involves the question as to what is the true net income, under the Corporation Tax Act of August 5, 1909, of a corporation purchasing property in one year and selling in another. It is of great importance both as involving the public revenues, generally, and as involving the true distinction between "capital" and "income."

If the case be advanced, it is requested that it be set down for hearing on the same date with Nos. 421

and 422 which involve similar principles with reference to the construction of the "income tax act" of Oct. 3, 1913.

Notice of this motion has been served upon opposing counsel.

OCTOBER, 1917.

JOHN W. DAVIS,
Solicitor General.

○

In the Supreme Court of the United States.

OCTOBER TERM, 1917.

THE UNITED STATES OF AMERICA, PETI- tioner, v. THE CLEVELAND, CINCINNATI, CHICAGO & St. Louis Railway Company.	}	No. —
--	---	-------

**PETITION FOR A WRIT OF CERTIORARI TO REVIEW
THE JUDGMENT OF THE CIRCUIT COURT OF APPEALS
FOR THE SIXTH CIRCUIT.**

The Solicitor General, on behalf of the United States, prays for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Sixth Circuit in the above-entitled cause.

STATEMENT.

The Cleveland, Cincinnati, Chicago & St. Louis Railway Company, hereinafter called the Big Four, in January, 1900, purchased on the New York stock market 30,000 shares of the Chesapeake & Ohio Railway Company, a connecting line leading to tide-water, for \$981,427.92. (Rec. 15.) The object, of course, was to acquire control of the Chesapeake & Ohio for the benefit of the Big Four. It being found

impossible to attain this end, the stock was sold on the same market on January 28, 1909, for \$1,795,719 (Rec. 15). The difference between the two amounts—namely, \$814,291.08—was entered by the Big Four on its books of account to the credit of “profit and loss,” this being its regular account covering such items as a business man would call “profit or loss.” (Rec. 15.) The last actual sales of Chesapeake & Ohio stock on the market prior to January 1, 1909, were on December 24, 1908, when quotations ranged from 58 $\frac{3}{8}$ to 57 $\frac{5}{8}$. The stock market quotation on the stock on December 31, 1908, ranged from 57 $\frac{1}{4}$ to 56 $\frac{3}{4}$. The lowest market quotation between December 24 and January 28 was on January 6, when it ranged from 56 $\frac{1}{2}$ to 55 $\frac{5}{8}$. (Rec. 15.)

The Big Four Company made no return on account of this sale of Chesapeake & Ohio stock, and this action was brought directly by the United States to recover the tax upon the difference between what the stock cost and what it sold for. (Rec. 2, 4.) The District Court decided in favor of the United States. (Rec. 6–11.) The Court of Appeals reversed the judgment, allowing the United States only the difference between the value of the stock on January 1, 1909, and January 28, 1909. (Rec. —, —, Fed. —.)

QUESTION INVOLVED.

Whether, when a railroad company purchases, prior to January 1, 1909, stock in another railroad company and sells the same during the taxing year in question, the proceeds of such sale, or any part

thereof (and if so what part), are gross income of the corporation within the meaning of the corporation tax act of August 5, 1909 (36 Stat. 11, 112).

REASONS FOR ALLOWANCE OF THE WRIT.

1. On December 11 last in the case of *Hays, Collector, v. The Gauley Mountain Coal Company*, No. 790, October Term, 1916, this court granted a writ of certiorari upon precisely the same point involved in the present case.

2. The decision of the Court of Appeals in the case at bar is based admittedly upon the decision of the same court in *Doyle v. The Mitchell Brothers Lumber Company*, 235 Fed. 686, and *Biwabik Mining Company v. United States*, — Fed. —. On the 21st day of May, 1917, this court granted a writ of certiorari in the *Doyle case*, and an application for a writ of certiorari in the *Biwabik Mining Company case* is submitted at the same time with this application.

3. The question involved in the case at bar is a very important one as affecting the proper determination of what is capital and what is income. This court has granted writs of certiorari in several cases raising this point, and other cases involving the point are pending in this court on writ of error. It is important that this court should have before it as many cases as possible illustrating the different conditions of business affairs under which this question arises and becomes important.

4. The case of *Gray v. Darlington*, 15 Wall., 63, in which the same point is raised as in the case at

bar, has never been before the court since its decision, and it is believed to be highly important that this court should determine whether *Gray v. Darlington* applies to the peculiar language of the corporation tax act.

BRIEF IN SUPPORT OF THE PETITION.

1. The court's attention is called to the petition for the writ of certiorari in the *Gauley Mountain case*, No. 790, October Term, 1916. It will be noted that the point raised is precisely the same as that raised in the present case, and that the present case is referred to in the petition as pending undecided in the Court of Appeals, and as furnishing an additional reason for the granting of the writ of certiorari in the *Gauley Mountain case*.

2. The principle laid down in the *Doyle case*, *supra*, is that the income upon property is the difference between its value at the beginning of the taxing year and its value at the end thereof, and this principle was applied to the present case to such an extent as to measure the value by the mere quotations of the stock on the stock exchange at New York on January 1, 1909. This principle changes the tax from an excise measured by income into a tax upon capital itself. It is therefore directly contrary to the language of the act, and is in principle contrary to the decision of this court in *Flint v. The Stone-Tracy Company*, 220 U. S., 107, 146, where this court said:

This tax, it is expressly stated, is to be equivalent to 1 per centum of the entire net

income over and above \$5,000 received from *all sources* during the year; this is the measure of the tax explicitly adopted by the statute. The income is not limited to such as is received from property used in the business, strictly speaking, but is expressly declared to be upon the entire net income above \$5,000 from all sources, excluding the amounts received as dividends on stock in other corporations * * * subject to the tax. In other words, the tax is imposed upon the doing of business of the character described and the measure of the tax is to be the income, with the deduction stated, received not only from property used in business, but from every source (146). The evident purpose is to secure a return of the entire income, with certain allowances and deductions which do not suggest a restriction to income derived from property actively engaged in the business (147).

It is also contrary in principle to the decision of this court in *Brushaber v. Union Pacific Co.*, 240 U. S. 1, where it was held that the income tax, even under the new amendment, was not a tax upon property, but was a true excise measured by the income received. The corporation tax act expressly measures the tax by the gross income received from all sources during the year, and it is impossible to twist these words so as to make them mean merely the increase in value of property during the year.

3. The Court of Appeals is peculiarly illogical in stating the income derived as the difference in value of the stock between January 1 and January 28.

There is no significance in these two dates. It might as well be said that the value of the stock on January 28 should be taken, in which case there would be no income at all, since, presumably, the stock on that date was worth the price it brought. The logical result of the court's decision is that income is to be determined by a chart showing the various fluctuations of property during the taxing year—e. g., on the stock exchange.

4. It must be admitted that superficially the case of *Gray v. Darlington*, *supra*, is contrary to the Government's contention, but a closer examination shows that this is not the case. The language of the act there under consideration was that the tax should be assessed "upon the gains, profits, and income for the year." The court laid stress upon this language, making the following statement (15 Wall. 65):

This language has only one meaning, and that is that the assessment, collection, and payment prescribed are to be made upon the annual production or income of one's property or labor, or such gains or profits *as may be realized from a business transaction begun and completed during the preceding year.* [Italics mine.]

No such construction can be placed upon the language of the corporation tax act. The basis of the assessment is distinctly stated to be the gross income received during the year from all sources. Evidently such language can not be limited to transactions begun and completed in the taxing year, but must be extended to all services or advantages derived from

capital during the year. This basis having been reached, the statute permits the deduction of certain specific items, and of those only, *Anderson v. 42 Broadway*, 239 U. S. 69. Evidently there would be very little income received from the operations of ordinary business corporations if only transactions begun and completed in the taxing year in question were taken into consideration.

It is submitted that the writ should issue as prayed.

JOHN W. DAVIS,
Solicitor General.

○

THE HISTORY OF THE
CITY OF BOSTON
FROM THE FIRST SETTLEMENT
TO THE PRESENT TIME
IN TWO VOLUMES
BY NATHANIEL BENTLEY
OF THE BARRISTER AT LAW
IN GREAT BRITAIN
AND OF THE COUNSELLOR AT LAW
IN MASSACHUSETTS
VOL. I.
BOSTON: PUBLISHED BY
J. B. ALLEN, 1827.

Supreme Court of the United States.

OCTOBER TERM, 1917.

THE UNITED STATES OF AMERICA,
Petitioner,

No. 593.

vs.

THE CLEVELAND, CINCINNATI, CHICAGO & ST.
LOUIS RAILWAY COMPANY,
Respondent.

On a Writ of Certiorari from the United States Circuit Court of
Appeals for the Sixth Circuit.

Argument for The Cleveland, Cincinnati,
Chicago & St. Louis Railway
Company.

As a matter of convenience we will refer to the parties
as they stood in the District Court, viz., to the petitioner
as plaintiff and to the respondent as defendant.

STATEMENT.

There was no dispute about the facts, as appears from
the Bill of Exceptions (Rec., pp. 11 and 12). The only
evidence offered at the trial in the District Court was the

Stipulation (Rec., pp. 12, 13 and 14), so that the only question presented is the legal effect of the conceded facts. These, so far as they are material to the question we wish to present, are as follows (Rec., pp. 12 and 13):

In January, 1900, the defendant purchased on the New York stock market thirty thousand shares of the capital stock of the Chesapeake & Ohio Railway Company for the sum of \$981,427.92. On January 28, 1909, the defendant sold this stock in the same market for the sum of \$1,795,719.00. The difference between these two amounts was entered by the defendant on January 31, 1909, in its books, to the credit of profit and loss. Defendant did not include this difference in its tax return made under Section 38 of the Act of Congress approved August 5, 1909 (36 Stats., 112), and the plaintiff, claiming that this amount was part of the net income of the defendant subject to taxation under this Act, brought this suit to recover the amount thereof.

The court at the trial directed a verdict in favor of the plaintiff for certain sums admitted to be due, and for the sum of one per cent. on the difference between the amount for which the Chesapeake & Ohio stock was bought and the amount for which it was sold, with interest (Rec., pp. 11 and 12). To this the defendant excepted; and judgment was entered on this verdict. The Circuit Court of Appeals reversed this judgment (Record, p. 19) and the United States has brought the case here asking for a review of this reversal.

ARGUMENT.

The Act in question (36 Stats. at Large, 112) provides:

“That every corporation, joint stock company
or association * * * shall be subject to pay
annually a special excise tax * * * equiva-

lent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year."

This question has been settled by the decision of this court in *Gray v. Darlington*, 15 Wall., 63. The opinion of the court in that case on this subject is as follows (p. 65):

"The question presented is whether the advance in the value of the bonds, during this period of four years, over their cost, realized by their sale, was subject to taxation as gains, profits, or income of the plaintiff for the year in which the bonds were sold. The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits and income. Its general language is 'that there shall be levied, collected, and paid *annually* upon the gains, profits, and income of every person,' derived from certain specified sources, a tax of five per cent., and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st of December next preceding the time for levying, collecting, and paying said tax.' This language has only one meaning, and that is that the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the

preceding year. There are exceptions, as already intimated, to the general rule of assessment thus prescribed. One of these exceptions is expressed in the statute, and relates to profits upon sales of real property, requiring, in the estimation of gains, the profits of such sales to be included where the property has been purchased not only within the preceding year, but within the two previous years. Another exception is implied from the provision of the statute which requires all gains, profits, and income derived from any source whatever, in addition to the sources enumerated, to be included in the estimation of the assessor. The estimation must, therefore, necessarily embrace gains and profits from trade and commerce, and these, for their successful prosecution, often require property to be held over a year. In the estimation of gains of any one year the trader and merchant will, in consequence, often be compelled to include the amount received upon goods sold over their cost, which were purchased in a previous year. Indeed, in the estimation of the gains and profits of a trading or commercial business for any one year, the result of many transactions have generally to be taken into account which originated previously. Except, however, in these and similar cases, and in cases of sales of real property, the statute only applies to such gains, profits, and income as are strictly acquisitions made during the year preceding that in which the assessment is levied and collected.

“The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital.

"The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place. We are satisfied that no such result was intended by the statute."

The learned Judge of the District Court, in his opinion (Rec., pp. 5 and 6), attempted to make a distinction between the income tax law of 1867, under which the case of *Gray v. Darlington* arose, and the Act of 1909, under which the present case arises. We must confess that the distinction which the learned Judge draws seems to us, if a distinction at all, to be a distinction without a difference. It seems to us that when Congress, in the later Act, said "net income" received from all sources during such year, it said exactly the same thing that it said in 1867 (14 Stats. at Large, 478), "the gains, profits and income for the year." The learned Judge in his opinion assumed as the foundation of his reasoning that the thirty thousand shares of Chesapeake & Ohio Railway Co. stock in question had not paid any dividends during the time it was held by defendant. There was no evidence on this subject, and his assumption was unwarranted. If any inference is to be drawn from the facts, it is that the great advance in the value of the stock was due to the fact that the company had begun paying dividends. At any rate,

under the rule stated in *Gray v. Darlington* the income from this stock would be the dividends paid on it and if there were no dividends there was no income.

As the opinion of the Circuit Court of Appeals is printed in the record (pp. 20 and 21) we ask this court to consider what seem to us the very cogent reasons given by that court for the result reached by it. We feel that we can say little that has not already been better said by the Circuit Court of Appeals. We must, however, say that we feel that that court took too narrow a view of the decision of this court in *Gray v. Darlington*. That court said (Rec., p. 21): "The precise point decided in *Gray v. Darlington* was that the accretions in value during the previous years were not income for the year in which the property was sold; but, doubtless some of the language of the opinion would indicate that such accretions were not income even for the year in which they happened." In thus limiting the effect of that decision the court below fell into an error. In *Gray v. Darlington*, Mr. Darlington who had sold some United States bonds, which he had held for four years, at an advance over their cost, had been compelled to pay an income tax on the entire amount of the difference between the cost and the selling price of the bonds, it did not appear how much, if any, of the advance occurred during the year in which the bonds were sold. After taking all proper steps he sued the collector of internal revenue to recover the tax thus paid and in the court below he recovered the whole of it as it apparently did not occur to the court to make any distinction between the years. The judgment thus recovered was affirmed by this court. We are not asking this court to review the decision but we call attention to this error of the

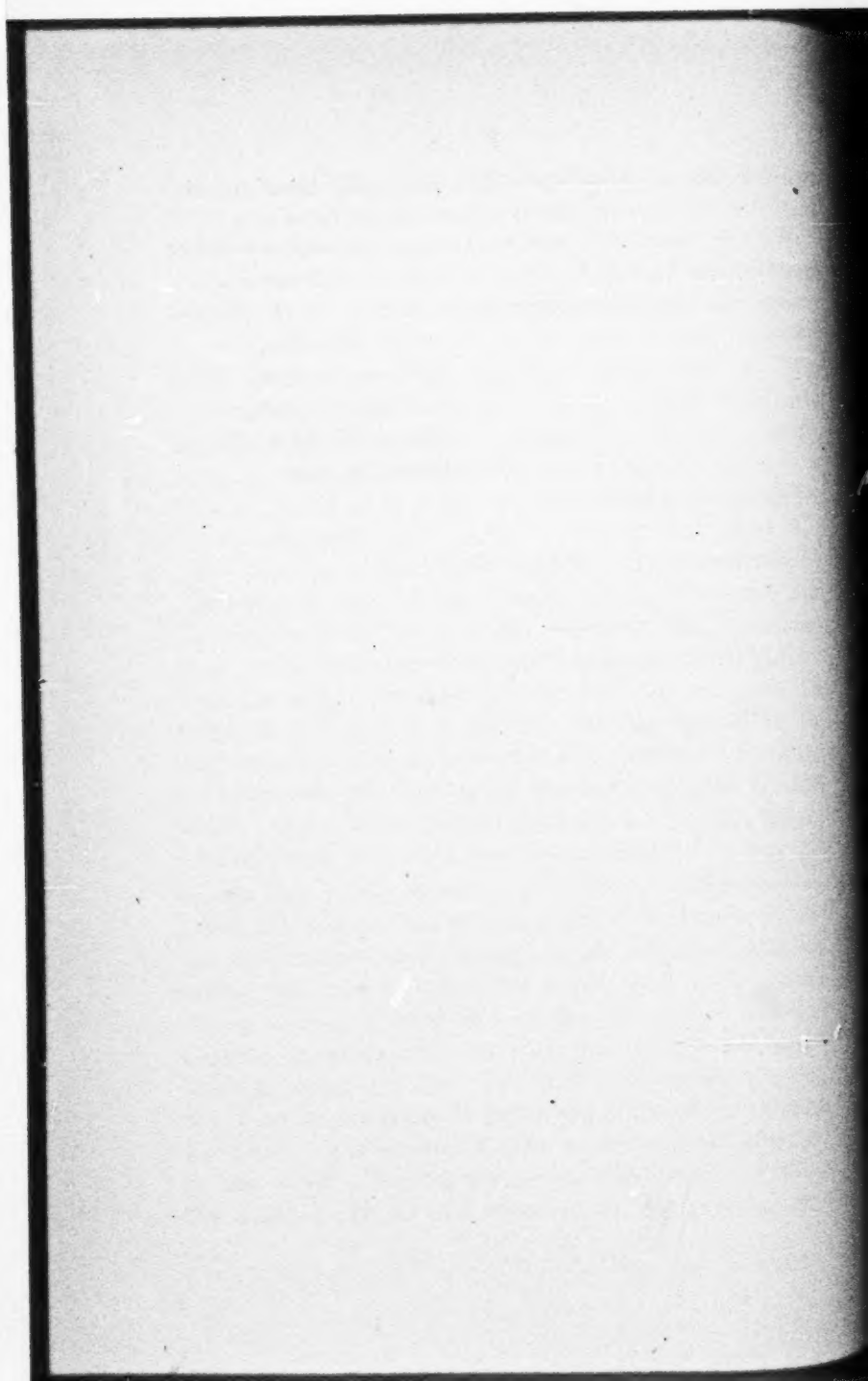
court below so as to show that we really have not obtained from the court below all we should have had.

We ask therefore for the reasons given that the judgment of the Circuit Court of Appeals be affirmed.

Respectfully submitted,

JUDSON HARMON,
EDWARD COLSTON,
A. W. GOLDSMITH,
GEORGE HOADLY,
OSCAR STOEHR.

December 4, 1917.



Supreme Court of the United States

THE UNITED STATES OF AMERICA,
Petitioner.

vs.

THE CLEVELAND, CINCINNATI, CHICAGO
& ST. LOUIS RAILWAY COMPANY.

No. 593.

Additional Argument for the Respondent.

Our original argument was, of necessity, prepared without having had the opportunity to see the brief on behalf of the United States, and the time since our receipt of that brief has been so short that we trust the court will pardon us if this argument is not as orderly and systematic as we should have wished to make it.

We have read the argument for the United States carefully, and it seems to us to lead to results that are, to say the least, unreasonable. If we follow the argument to its logical conclusion, it leads to the result that all receipts which may come to a man's hands during the year are income. For example, if A subscribe for stock in a corporation, and pay par for it and the enterprise is abandoned, and the corporation dissolved, and

the assets after deduction of the expenses are sufficient to repay to the subscribers ninety-five per cent. of what they paid in, according to the argument of counsel (see page 37 of their brief) this ninety-five per cent. is income, and if it is not taxed as such that is owing to the grace of Congress, not to the character of what is received. Nay more, if the corporation had invested its capital thus raised in real estate, and if, instead of selling it and distributing the proceeds in cash, the real estate had been conveyed to the stockholders as tenants in common in proportion to their several interests, the argument made leads directly to the conclusion that the value of such real estate is income to the stockholder although it may be less than the amount he paid for his stock and although he may thus have suffered a substantial loss.

Counsel will, no doubt, say that they do not make this claim. Perhaps not, though it seems to us that they come pretty near it (see pp. 37, 39 and 89, and especially the last page where it seems to us they claim that the entire proceeds of this sale were income and taxable as such), but that certainly is, as shown by the passages referred to and others, the necessary result of what they do claim.

It seems to be clear that such a result is entirely in conflict with any true view of the nature of income as distinguished from capital or principal, and to lead to a confusion of the income tax, or, in this case, a tax measured by income, with a general property tax. The purpose of an income tax is to impose the expenses of government, to the extent of the tax, on the annual increase of the wealth of the country, whether such increase be

the result of the employment of capital or of personal effort, and a rule which would result in the taxation of existing property every time it changes its shape does not provide for an income tax at all, but for a tax upon property, and not even a tax upon all property but a tax upon some property, that subject to it being determined at haphazard by the mere chance that it may have changed hands, or that its shape may have been transformed, or that the owner, instead of holding it through a trustee or a corporation, may hold it directly.

The questions presented in these various cases, though similar, are not identical and we shall therefore limit this argument to the case presented by the record in No. 593, *The United States against the Cleveland, Cincinnati, Chicago & St. Louis Railway Company*.

This corporation was a railroad company presumably organized to own and operate a railroad, not to deal in stocks, and when, in January, 1900, it bought twenty thousand shares of stock in a connecting line, it is to be presumed that it did so to further the friendly relations between them and with the intention of retaining these shares permanently and not as mere speculation. If so, these shares became part of the capital of *The Cleveland, Cincinnati, Chicago & St. Louis Railway Company*, and their proceeds when sold were also part of its capital and not profits. Counsel say (p. 89) that these proceeds were legally available for distribution as profits, in the same manner as would have been the proceeds of the sale of worn out engines or rails. The illustration used by counsel seems to us to show that counsel is wrong in his conclusion, for the proceeds of the sale of worn out engines and rails are cer-

tainly not available for distribution as profits, for several reasons. First, the railroad company is bound to the public to properly maintain its track and equipment and, therefore, the proceeds of the sale of worn out engines or rail should as a matter of public duty be applied to such maintenance; Second, under the laws of Ohio, in which state the company is incorporated, and in which it has its principal office (see petition, Record p. 1), it is provided that no corporation shall make dividends except from the surplus profits arising from the business of the corporation. (Act of April 11, 1888, 85 Ohio Laws, 182, 183, printed as an appendix hereto.) Thus the statute of Ohio enforces the general rule that dividends can be paid only out of profits. In *Mobile & Ohio Railroad v. Tennessee*, 153 U. S. 486, at page 496, Jackson, J., in delivering the opinion of this court, and as to this feature there was no dissent, said:

"Again, dividends can be rightfully paid only out of profits. Corporations are liable to be enjoined by shareholders or creditors from making a distribution, in dividends, of capital. Taylor on *Corporations*, section 565, and authorities cited.

"The term 'profits', out of which dividends alone can be properly declared, denotes what remains after defraying every expense, including loans falling due, as well as the interest on such loans. *Correy v. Londonderry Railway Co.* 29 Beav. 263."

Counsel for the petitioner have cited in their brief a large number of cases, most of which have no direct bearing on the facts of this case, but such of them as have fully support the decision of the Circuit Court of Appeals and would have warranted it in holding that

no part of the proceeds of this sale was taxable. In *In the matter of the Income Tax Acts*, 25 Victorian Law Reports 679, the facts were that the taxpayer had at various times bought 1326 shares of the stock of a corporation for which he paid sixteen hundred and fifty-seven pounds ten shillings (£1657.10.0). He sold them some years later for thirty-eight hundred and eighty-four pounds one shilling (£3884.1.0), making a difference in his favor of twenty-two hundred and twenty-six pounds eleven shillings (£2226.11.0). The taxing officers considering that this difference or profit was income, assessed him for income tax on that amount and the court in holding that it was not taxable said:

"This money is an accretion to the taxpayer's capital, and not income."

We can see no difference between that case and the case at bar.

In *State ex rel Bundy v. Nygaard*, 163 Wis. 307, 158 N. W. 87, the facts were that the relator had on September 1, 1907, bought a number of shares in a corporation at a total price of ~~\$10,000.00~~ ^{\$110,000}. Before the going into effect of the income tax law of Wisconsin, they had advanced until they were worth \$214,000.00. The income tax law of Wisconsin provided that the term income shall include "all profits derived from the transaction of business or from the sale of real estate or other capital assets; provided, that of the profits derived from the sale of real estate or other capital assets acquired previous to January 1, 1911, only such proportion shall be taxable as the time between January 1, 1911, and the date of sale bears to the entire time between the date of acquisition and the date of sale"

On February 20, 1914, the relator sold the shares in question for \$214,000.00, there having been no further rise in their value after January 1, 1911. The state tax commission acting, as they claimed, under the provisions of the statute quoted above, assessed the relator for income tax on the sum of \$50,413.23. The court held that this was improper and said:

"When the income tax law was first passed in 1911, the stock in question was held by the plaintiff and was then of the value of \$214,000.00. This fact is admitted to be established. In the judgment of the court all of this was capital, or, in other words, property. Its status was fixed. No part of it could be made into income by legislative enactment."

There is no inconsistency between the case just cited and the other Wisconsin cases, under the statute of Wisconsin (Section 1087, M. 2, subd. (d)), which so far as material is as follows:

"The term income as used in this act shall include * * * (d) all dividends from * * * stock,"

dividends were subject to be taxed as a part of the income of the person receiving the same, and the question involved was whether dividends declared and paid after the income tax law went into effect, though paid out of the receipts of the corporation for a period prior to its going into effect, were subject to the income tax. The court held that they were. The principle of the decision is that the stockholder has no individual interest in the earnings of the corporation until a dividend has been declared and that when dividends are declared and paid,

and not until then, do they become income of the stockholder. Had the question been as it was in *State v. Nygaard*, whether the undistributed earnings of the period prior to the going into effect of the income tax law were income of the corporation for the tax period, there can be no doubt that the court would have held that they were not. It is not necessary for us to determine whether the other Wisconsin cases were correctly decided or not; it is enough for our purpose that they are in no way inconsistent with the *Burdy* case. We wish, however, to call attention to the fact that counsel have completely misunderstood the opinion of Winslow, C. J., referred to at the foot of page 45 of their brief, and, as a result, have done a serious injustice to that judge. What he did say was that if A has a piece of property which at the date of the taking effect of the income tax law was worth \$10,000.00, and thereafter sells it for \$10,000.00, no part of that sum is income; it is merely a change in the shape of his capital. If, however, B performs services for A and A in payment for those services conveys the property to B, then the value of the property thus conveyed is income to B.

Counsel seek to deprive the cases of *Bailey v. Railroad Co.*, 106 U. S. 109, and *Merchants Ins. Co., v. McCartney*, 12 Int. Rev. Rec. 122, of their force, which counsel evidently feel, by saying that the former case "is not particularly significant because of the doubt whether the tax was levied on the stockholder or on the corporation." A reading of the act will remove the doubt and will show that the tax on the dividends was a tax on the stockholder, though it was collected at the source, as the company was required to withhold it. The statute so

far as material is a part of Section 120 of the Act of June 30, 1864, 13 Statutes at large, page 283, and is printed as Appendix B hereto.

In the latter of the above two cases Judge Lowell said:

"As to the three-tenths"—a distribution among the stockholders of the Suffolk Bank of profits accumulated prior to the passage of the first income tax act—"it seems to me to have been a division of capital, a return to the plaintiffs in money of a part of the property which was already in their ownership as capital stock when the first tax act was passed. If the Suffolk bank had been wholly wound up, and had returned to its stockholders the exact value of their shares in money, having made no profits since the passage of the original act, this sum of money could not be taxed as income, gains or profits; and so of a part."

We have discussed *Gray v. Darlington* in our former brief and have nothing that would be of profit to add to that discussion except by quoting the following language of Mr. Justice Field, who delivered the opinion of the court:

"The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital." (Italics ours.)

We are unable to see any difference in principle between the present case and that of *Towne v. Eisner* recently decided by this court, and it seems to us that the present case must be governed by the decision of the court in that case.

For the reasons given above, as well as those given by the Circuit Court of Appeals in its opinion, we ask an affirmance of the judgment below.

Respectfully submitted,

JUDSON HARMON,
EDWARD COLSTON,
A. W. GOLDSMITH,
GEORGE HOADLY,
OSCAR STOEHR,

*Attorneys for The Cleveland, Cincinnati,
Chicago & St. Louis Railway Company.*

February 28, 1918.

APPENDIX A.

(Senate Bill No. 61).

AN ACT

To regulate the payment of dividends by the directors of corporations, and supplementary to chapter 1, title 2, part 2, of the Revised Statutes of the State of Ohio.

Section 1. *Be it enacted by the General Assembly of the State of Ohio*, That it shall not be lawful for the directors of any corporation organized under the laws of this state to make dividends except from the surplus profits arising from the business of the corporation.

Section 2. In the calculation of the profits of any corporation previous to a dividend, interest then unpaid, although due, on debts owing to the company, shall not be included.

Section 3. In order to ascertain the surplus profits, from which alone a dividend can be made, there shall be charged in the account of profit and loss, and deducted from the actual profits:

1. All the expenses paid or incurred, both ordinary and extraordinary, attending the management of the affairs and the transaction of the business of the corporation.

2. Interest paid, or then due, on debts owing by the corporation.

3. All losses sustained by the corporation; and in the computation of such losses, all debts owing to the corporation shall be included, which shall have remained due, without prosecution, and no interest having been paid thereon for more than one year, or, on which judgment shall have

been recovered, that shall have remained for more than two years unsatisfied, and on which no interest shall have been paid during that period; and no such corporation shall advertise a larger amount of capital stock than has actually been subscribed and paid in.

Section 4. Every director who shall violate, or be concerned in violating, any provision in the preceding sections of this act contained, shall be liable personally to the creditors and stockholders respectively, of the corporation of which he shall be a director, to the full extent of any loss they may respectively sustain from such violation.

Section 5. This act shall take effect from and after its passage.

NOAH H. ALBAUGH,
Speaker *pro tem.* of the House of Representatives.

WM. C. LYON,
President of the Senate.

Passed April 11, 1888.

APPENDIX B.

Section 120. *And be it further enacted*, That there shall be levied and collected a duty of five per centum on all dividends in scrip or money thereafter declared due, and whenever the same shall be payable, to stockholders, policy-holders, or depositors, as part of the earnings, income, or gains of any bank, trust company, savings institution, and of any fire, marine, life, inland insurance company, either stock or mutual, under whatever name or style known or called, in the United States or territories, whether specially incorporated or existing under general laws, and on all undistributed sums, or sums made or added during the year to their surplus or contingent funds; and said banks, trust companies, savings institutions, and insurance companies shall pay the said duty, and are hereby authorized to deduct and withhold from all payments made on account of any dividends or sums of money that may be due and payable as aforesaid, the said duty of five per centum.

Opinion of the Court.

UNITED STATES v. CLEVELAND, CINCINNATI,
CHICAGO & ST. LOUIS RAILWAY COMPANY.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE
SIXTH CIRCUIT.

No. 593. Argued March 4, 5, 6, 1918.—Decided May 20, 1918.

A railroad company bought shares of another railroad company before, and sold them after, December 31, 1908. *Held*, that only so much of the profit as accrued after that date was "income," within the Corporation Tax Act. *Doyle v. Mitchell Brothers Co.*, *ante*, 179; *Hays v. Gauley Mountain Coal Co.*, *ante*, 189. 242 Fed. Rep. 18, affirmed.

THE case is stated in the opinion.

The Solicitor General, with whom *Mr. Wm. C. Herron* was on the brief, for the United States.

Mr. George Hoadly, with whom *Mr. Judson Harmon*, *Mr. Edward Colston*, *Mr. A. W. Goldsmith* and *Mr. Oscar Stoehr* were on the briefs, for respondent.

Mr. Robert R. Reed, by leave of court, filed a brief on behalf of the Investment Bankers' Association of America, as *amicus curiæ*.

MR. JUSTICE PITNEY delivered the opinion of the court.

In January, 1900, the respondent purchased 30,000 shares of stock of the Chesapeake & Ohio Railway Company for \$981,427.92, and sold them January 28, 1909, for \$1,795,719—a profit of over \$814,000. It included no portion of this profit in its return for the year 1909 under the Corporation Excise Tax Act of August 5,

1909, c. 6, 36 Stat. 11, 112, § 38, and the United States brought this suit to recover the tax of 1 per cent. thereon. The District Court directed a verdict in favor of plaintiff. Upon review the Circuit Court of Appeals held the proceeds of sale of the stock could not be considered as income under the act except to the extent by which they exceeded the market value of the stock on December 31, 1908, ascertained to be \$57 per share. It therefore reversed the judgment, and remanded the case with instruction to enter a new judgment to include a tax on this account only upon the balance of the selling price above \$57 per share or \$1,710,000 in all. 242 Fed. Rep. 18. A writ of certiorari was then allowed.

For reasons sufficiently stated in *Doyle v. Mitchell Brothers Co.*, and *Hays v. Gauley Mountain Coal Co.*, ante, pp. 179, 189, we concur in the view that defendant was not taxable except with respect to so much of the profit upon the stock as accrued after December 31, 1908. Just how this part is to be separated from that which previously accrued is a matter of some nicety, as we have shown in the *Hays Case*. The Circuit Court of Appeals adopted the theory of an inventory taken as of the time the act went into effect; and although the assets here under consideration were not acquired for the purpose of sale in the manner of merchandise, but were bought for investment, and hence were not inventoried on December 31, 1908, it accepted the stipulated fact that the stock had a regular market value of \$57 per share on that date as supplying the lack of an inventory. This result accords with the views we have expressed in the cases referred to.

Judgment affirmed.

MR. JUSTICE HOLMES took no part in the consideration or decision of this case.